

**Internal Revenue Service
Director, Exempt Organizations
Rulings and Agreements**

**Department of the Treasury
P.O. Box 2508
Cincinnati, OH 45201**

Date:

Employer Identification Number:

Person to Contact – I.D. Number:

Contact Telephone Numbers:

Phone

FAX

LEGEND:

Uniform Issue List:

A= Founder
B= Individual #2
C= Individual #3
D= Individual #4
E= Individual #5
F= Individual #6
G= Individual #7
M= Applicant
N= Related for-profit company
O= State
P= Date
Q= Applicant's original name
R= Date
S= Date
T= Date
U= Competitor #1
V= Competitor #2
W= Date
X= Date
Y= Amended Charitable Program
Z= Game
WW= December 31, 2006
XX= Date
YY= Date

501.03-00

Dear Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust, or Form 1120 if you are a corporation or an unincorporated association. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b) (2) of the Internal Revenue Code provides, in part, that:

A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination. In that event, appropriate State officials will be notified of this action in accordance with the provisions of section 6104(c) of the Code.

This letter supersedes our letters dated XX, YY and X.

Sincerely,

Director, Exempt Organizations
Rulings and Agreements

Enclosures:

Enclosure I

M was incorporated in the State of O on P, under the name of Q, to operate exclusively for charitable or educational purposes, including for such purpose, but without limitation thereon: to combat community apathy, discrimination and prejudice; to reduce illiteracy and to foster learning through educational games.

M's articles were amended on R to change its name to M.

Page 2 of M's Form 1023 states its purposes are to provide grant writing, seminars, lectures, workshops, tutorial services, notary services, cooperative advertisements and consultations.

In an Application for Reinstatement, filed with the State of O on S, A is listed as President and Director of M.

In response to our additional information letter dated T, many of M's responses referred to its Business Plan. A review of M's Business Plan indicates that there is another entity associated with this entity. a for-profit business owned by A, known as, N.

M provides grant writing, consultations, seminars, workshops, lectures, tutorial, services, and notary services. These are the same services as provided by N.

M's Business Plan states it is in direct competition with U and the V.

M further states in its Business Plan that the activities of the M and N are the same. Clients who cannot afford the for-profit N are referred to the non-profit M.

Subsequent information disclosed that M does not have any educational materials and its tutorial services, which are provided through the Internet, are for N only.

M's income will be derived from grants, fundraisers, service fees and membership dues.

Correspondence received on W shows M's comparison pricing chart, which shows a "firm price" for income levels of \$0-\$10,000 (30%) and a price for income levels of \$10,000-\$20,000 (50%).

In response to our proposed denial letter dated X, M submitted a new Form 1023 application stating the new purposes of the corporation will be:

1. Membership Drives- 25% of time:
There will be a spring membership drive in the month of March each year. In addition to that, there will be an annual membership drive held in September each year.
2. The Y - 50% of time:

Learning Baskets will be distributed to non-profit organizations with 501(c) (3) status, families and individuals. Learning Baskets may contain learning resources such as books, supplies, educational materials, computers, computer software, travel trips and local community activities tickets, as well as cash incentives. Baskets will be distributed: Easter, summer, Thanksgiving and Christmas.

3. Essay Contests -25% of time:

Six contests will be held throughout the year. The topics will change annually.

The members of M's governing body listed in the new application are: B, C, D, E, F and G.

Subsequent information revealed:

N will no longer provide grant writing, seminars, lectures, workshops, tutorial service, notary services, cooperative advertisement and consultations.

The Y plans to distribute a minimum of four baskets with a retail value of four hundred up to one thousand dollars each quarter with books, CD-ROMs, DVDs, a computer, computer software and Community Incentive Program Tickets (CIPT) that will stimulate the home learning environment. Non-Profits will be matched with local agencies, schools and churches to provide a calendar of educational contests throughout the year.

Educational materials, donated by corporations for distribution in learning baskets are available when received. The Z is not a guaranteed inclusion in learning baskets. Upon availability only; a specified number of games will be donated to N for distribution in learning baskets. Other games with a learning focus will be distributed instead of the Z when the game is not available.

M states the following: 1) The "for-profit" N, does not exist. 2) The fictitious name registration was done in error. 3) The expiration date is WW. 4) There is a charge to cancel the registration. 5) The cancellation has been requested.

A is the mother of B and E; the sister and aunt of D and F, respectively. A is not related to C. A response was not provided regarding G.

M did not submit copies of its educational material nor did it submit samples of the "other contents" of the learning baskets.

Section 501(c)(3) of the Internal Revenue Code provides for exemption from Federal income tax for organizations, which are organized and operated exclusively for charitable, religious, and educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 502 of the Internal Revenue Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be tax exempt on the grounds that all of its profits are payable to exempt organizations.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to qualify for exemption under section 501(c)(3), an organization must be both organized and operated exclusively for one or more exempt purposes. Failure to meet either the organizational or operational test will disqualify an organization from exemption under section 501(c)(3).

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities, which accomplish such purposes. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. Thus, in construing the meaning of the phrase "exclusively for educational purposes" in Better Business Bureau v. United States, 326 U.S. 279 (1945), the Supreme Court of the United States stated, "This plainly means that the presence of a single non-educational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes."

Section 1.501(c)(3)-1(e)(1) of the Regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operations of such trade or business are in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of activities, which are in furtherance of one or more exempt purposes.

Section 1.513-1(d)(2) of the Regulations provides that a trade or business is "related" to exempt purposes only where the conduct of the business activity has a causal relationship to the achievement of any exempt purpose, and is "substantially related" for purposes of section 513, only if the causal relationship is a substantial one. Thus, for the conduct of a trade or business from which a particular amount of gross income derived to be substantially related to purposes for which exemption is granted, the production or distributions of goods or the performance of the services for which the gross income is derived must contribute importantly to the accomplishment of those purposes.

To qualify for exemption under section 501(c)(3), the applicant organization must show (1) that is organized and operated exclusively for exempt purposes, (2) that no part of the net earnings inures to the benefit of a private individual or shareholder, and (3) that no substantial part of its activities consists of dissemination of propaganda or otherwise attempting to influence legislation or engaging in political activity.

Revenue Procedure 90-27, published in Cumulative Bulletin, 1990-1, page 514 provides, in part, that exempt status will be recognized in advance of operations if proposed operations can be described in *sufficient* detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. A mere restatement of purposes or a statement that proposed activities will be in furtherance in such purposes will not satisfy this requirement. The organization must fully describe the activities in which it expects to

engage, including the standards, criteria, procedures, or other means adopted or planned, and the nature of contemplated expenditures.

Revenue Ruling 72-369, published in Cumulative Bulletin 1972-1, on page 245, holds that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under section 501(c)(3) of the Code. An organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. To satisfy the operational test of the Regulations, the organization's resources must be devoted to purposes that qualify as exclusively charitable within the meaning of section 501(c)(3) of the Code. The organization was not exempt because it was carrying on a trade or business of the type ordinarily carried on for profit.

After reviewing the facts of M's application, we have determined that M's non-profit organization is in direct competition with other non exempt entities. It does not differ from the activities of the for-profit N. In fact, the public would not be able to distinguish one from the other. As in the Better Business Bureau and Revenue Ruling 72-369, M may have an educational and/or charitable purpose but the commercial nature of M's organization defeats exemption. Thus M has failed the operational test under section of 501(c)(3).

The subsequent change in M was not supported by sufficient documentation to support its statement that is educational, thus based upon Revenue Procedure 90-27 cited above M has not provided the burden of proof that it is or will be operated within the purview of 501(c)(3) of the Code.

Although M meets the organizational test use section 1.501(c)(3)-1(b) of the Income Tax Regulations, M still does not meet the operational test as required under section 1.501(c)(3)-1(c) of the Regulations.

Accordingly, based upon the information submitted we have determined that M does not meet the requirements of section 501(c)(3) of the Internal Revenue Code.